Department of Finance 2007-03109/

News Release

Immediate release

Ottawa, December 21, 2006
2006-086

Canada's New Government Releases Draft Legislative Proposals to Implement the Distribution Tax on Income Trusts and Partnerships

The Honourable Jim Flaherty, Minister of Finance, today released draft legislative proposals to implement those aspects of the Government's Tax Fairness Plan dealing with income trusts and other flow-through entities.

The Tax Fairness Plan responds to the tax imbalance created by publicly-traded trusts and partnerships, while also providing meaningful tax relief to Canadian pensioners, seniors and businesses in Canada.

The key elements of the Plan as it relates to income trusts and other flow-through entities are:

- A distribution tax to be applied on certain distributions and allocations from publicly-traded trusts and partnerships as set out in the Notice of Ways and Means Motion adopted with a strong majority in the House of Commons on November 7, 2006.
- For trusts and partnerships that begin trading after October 31, 2006, the tax will apply beginning with their 2007 taxation year.
- Existing publicly-traded trusts and partnerships will not be subject to the new measure until their 2011 taxation year (assuming those trusts and partnerships adhere to the guidelines on "normal growth" set out in the guidelines distributed by the Department of Finance on December 15, 2006).

"Canada's New Government is taking these important steps to restore balance and fairness to Canada's tax system," said Minister Flaherty. "If corporations don't pay their share of taxes, this tax burden will be shifted onto the shoulders of hard-working individuals and families. This draft legislation conforms with the announcement I made on October 31st, and we intend to proceed with our Tax Fairness Plan as presented."

The Government is seeking constructive commentary on the technical aspects of the draft legislative proposals to implement the Tax Fairness Plan as presented and conforming with the Notice of Ways and Means Motion adopted on November 7, 2006.

Interested parties are invited to provide comments on the draft legislative proposals regarding the distribution tax by January 31, 2007. Following this comment period, the Government intends to introduce legislation to implement all components of the Tax Fairness Plan, including the $1,000 increase to the age credit amount for seniors, pension income splitting, which will enable Canadian residents to split up to one-half of certain pension income with their resident spouse or common-law partner, and a further reduction in the general corporate income tax rate to 18.5 per cent in 2011.

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LEGISLATIVE PROPOSALS CONCERNING SPECIFIED INVESTMENT FLOW-THROUGH TRUSTS AND PARTNERSHIPS

1. (1) Subparagraph 53(2)(*h*)(i.1) of the *Income Tax Act* is amended by striking out the word "or" at the end of clause (A) and by adding the following after clause (A):

(A.1) that was deemed by subsection 104(16) to be a dividend received by the taxpayer, or

(2) Subsection (1) applies to taxation years that end after 2006.

2. (1) The definition "eligible dividend" in subsection 89(1) of the Act is replaced by the following:

"eligible dividend" « *dividende déterminé* »

"eligible dividend" means

(*a*) a taxable dividend that is received by a person resident in Canada, paid after 2005 by a corporation resident in Canada and designated, as provided under subsection (14), to be an eligible dividend, and

(*b*) in respect of a person resident in Canada, an amount that is deemed by subsection 96(1.11) or 104(16) to be a taxable dividend that is received by the person;

(2) Subsection (1) applies to taxation years that end after 2006.

3. (1) Section 96 of the Act is amended by adding the following after subsection (1.1):

Deemed dividend of SIFT partnership

(1.11) If a SIFT partnership is liable to tax for a taxation year under Part IX.1,

(*a*) paragraph (1)(*f*) is to be read as if the expression "the amount of the income of the partnership for a taxation year from any source or from sources in a particular place" were read as the expression "the amount, if any, by which the income of the partnership for a taxation year from any source or from sources in a particular place exceeds, in respect of each such source, the portion of the partnership's taxable non-portfolio earnings for the taxation year that is applicable to that source"; and

(*b*) the partnership is deemed to have received a dividend in the taxation year from a taxable Canadian corporation equal to the amount by which the partnership's taxable non-portfolio earnings for the taxation year exceeds the tax payable by the partnership for the taxation year under Part IX.1.

(2) Subsection (1) applies in respect of taxation years of a partnership that end after 2006, except that subsection (1) does not apply in respect of a partnership for its taxation years that end before 2011 if interests in or other securities of the partnership were, before November 1, 2006, listed on a stock exchange or other public market.

4. (1) The portion of subparagraph 104(6)(*b*)(i) of the Act before clause A is replaced by the following:

(i) such part (in this section referred to as the trust's "adjusted distributions amount" for the taxation year) of the amount that, but for

(2) Paragraph 104(6)(*b*) of the Act is amended by striking out the word "and" at the end of subparagraph (ii.1), by adding the word "and" at the end of subparagraph (iii) and by adding the following after subparagraph (iii):

(iv) where the trust is a SIFT trust for the taxation year, the amount, if any, by which

(A) its adjusted distributions amount for the taxation year

exceeds

(B) the amount, if any, by which

(I) the amount that would, if this Act were read without reference to this subsection, be its income for the taxation year

exceeds

(II) its non-portfolio earnings for the taxation year.

(3) Section 104 of the Act is amended by adding the following after subsection (15):

SIFT deemed dividend

(16) If an amount (in this subsection and section 122 referred to as the trust's "non-deductible distributions amount" for the taxation year) is determined under subparagraph (6)(*b*)(iv) in respect of a SIFT trust for a taxation year

(*a*) each beneficiary under the SIFT trust to whom at any time in the taxation year an amount became payable by the trust is deemed to have received at that time a taxable dividend that was paid at that time by a taxable Canadian corporation;

(*b*) the amount of a dividend described in paragraph (*a*) as having been received by a beneficiary at any time in a taxation year is equal to the amount determined by the formula

$$A/B \times C$$

where

A is the amount that became payable at that time by the SIFT trust to the beneficiary,

B is the total of all amounts, each of which became payable in the taxation year by the SIFT trust to a beneficiary under the SIFT trust, and

C is the SIFT trust's non-deductible distributions amount for the taxation year;

(*c*) the amount of a dividend described in paragraph (*a*) in respect of a beneficiary under the SIFT trust is deemed for the purpose of subsection (13) not to be an amount payable to the beneficiary; and

(*d*) for the purposes of applying Part XIII in respect of each dividend described in paragraph (*a*) the SIFT trust is deemed to be a corporation resident in Canada that paid the dividend.

(4) Subsection 104(24) of the Act is replaced by the following:

Amount payable

(24) For the purposes of subparagraph 53(2)(*h*)(i.1), paragraph (*c*) of the definition "specified charity" in subsection 94(1), subsection 94(8) and subsections (6), (7), (7.01), (13), (16) and (20), an amount is deemed not to have become payable to a beneficiary in a taxation year unless it was paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment of it.

(5) Subsections (1) to (4) apply in respect of taxation years of a trust that end after 2006, except that those subsections do not apply in respect of a trust for its taxation years that end before 2011 if units in or other securities of the trust were, before November 1, 2006, listed on a stock exchange or other public market.

5. (1) Subsection 120(3) of the Act is amended by striking out the word "and" at the end of paragraph (*b*), by adding the word "and" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) in the case of a SIFT trust, the amount, if any, by which its income for the year determined without reference to this paragraph exceeds its taxable SIFT trust distributions (as defined in subsection 122(3)) for the year.

(2) Subsection (1) applies in respect of taxation years of a trust that end after 2006, except that it does not apply in respect of a trust for its taxation years that end before 2011 if units in or other securities of the trust were, before November 1, 2006, listed on a stock exchange or other public market.

6. (1) Subsection 122(1) of the Act is replaced by the following:

Tax payable by *inter vivos* trust

122. (1) Notwithstanding section 117, the tax payable under this Part for a taxation year by an *inter vivos* trust is the total of:

(*a*) 29% of its amount taxable for the taxation year, and

(*b*) if the trust is a SIFT trust for the taxation year, the positive or negative amount determined by the formula

$$A \times B$$

where

A is the positive or negative decimal fraction determined by the formula

$$C + D - E$$

where

C is the net corporate income tax rate in respect of the SIFT trust for the taxation year,

D is the provincial SIFT tax factor for the taxation year, and

E is the decimal fraction equivalent of the percentage rate of tax provided in paragraph (*a*) for the taxation year, and

B is the SIFT trust's taxable SIFT trust distributions for the taxation year.

Amount deemed paid

(1.01) If the amount determined under subsection (1) in respect of a trust (other than a trust that is exempt from tax under this Part) for a taxation year is a negative amount, the absolute value of the amount is deemed to have been paid on account of the tax payable under this Part by the trust for the taxation year on the trust's balance-due day for the taxation year.

(2) Section 122 of the Act is amended by adding the following after subsection (2):

Definitions

(3) The following definitions apply in this section.

"non-deductible distributions amount" « *montant de distribution non déductible* »

"non-deductible distributions amount" for a taxation year has the meaning assigned by subsection 104(16).

"taxable SIFT trust distributions" « *montant de distribution imposable* »

"taxable SIFT trust distributions" of a SIFT trust for a taxation year means the lesser of

(*a*) its amount taxable for the taxation year, and

(*b*) the amount determined by the formula

$$A/(1 - (B + C))$$

where

A is its non-deductible distributions amount for the taxation year,

B is the net corporate income tax rate in respect of the SIFT trust for the taxation year, and

C is the provincial SIFT tax factor for the taxation year.

(3) Subsections (1) and (2) apply in respect of taxation years of a trust that end after 2006, except that those subsections do not apply in respect of a trust for its taxation years that end before 2011 if units in or other securities of the trust were, before November 1, 2006, listed on a stock exchange or other public market.

7. (1) The Act is amended by adding the following after section 122:

SIFT trust distributions: definitions

122.1 The following definitions apply in this section and in sections 104 and 122.

"entity" « *entité* »

"entity" means a corporation, trust or partnership.

"equity value" « *valeur des capitaux propres* »

"equity value", of an entity at any time, means the total fair market value at that time of

(*a*) if the entity is a corporation, all of the issued and outstanding shares of the capital stock of the corporation;

(*b*) if the entity is a trust, all of the income or capital interests in the trust; or

(*c*) if the entity is a partnership, all of the interests in the partnership.

"investment" « *placement* »

"investment", in a trust or partnership, means

(*a*) a property that is a security of the trust or partnership; or

(*b*) a right which may reasonably be considered to replicate a return on, or the value of, a security of the trust or partnership.

"non-portfolio earnings" « *gains hors portefeuille* »

"non-portfolio earnings", of a SIFT trust for a taxation year, means the total of

(*a*) the amount, if any, by which

(i) the total of all amounts each of which is the SIFT trust's income for the taxation year from a business carried on by it in Canada or from a non-portfolio property, other than income that is a taxable dividend received by the SIFT trust,

exceeds

(ii) the total of all amounts each of which is the SIFT trust's loss for the taxation year from a business carried on by it in Canada or from a non-portfolio property, and

(*b*) the amount, if any, by which

(i) the total of

(A) all taxable capital gains of the SIFT trust from dispositions of non-portfolio properties during the taxation year, and

(B) one-half of the total of all amounts each of which is deemed under subsection 131(1) to be a capital gain of the SIFT trust for the taxation year in respect of a non-portfolio property of the SIFT trust for the taxation year

exceeds

(ii) the total of the allowable capital losses of the SIFT trust for the taxation year from dispositions of non-portfolio properties during the taxation year.

"non-portfolio property" « *bien hors portefeuille* »

"non-portfolio property" of a trust or a partnership for a taxation year means a property, held by the trust or partnership at any time in the taxation year, that is

(*a*) a security of a subject entity, if at that time the trust or partnership holds

(i) securities of the subject entity that have a total fair market value that is greater than 10% of the equity value of the subject entity, or

(ii) securities of the subject entity that, together with all of the securities that the trust or partnership holds of entities affiliated with the subject entity, have a total fair market value that is greater than 50% of the equity value of the trust or partnership;

(*b*) a Canadian real, immovable or resource property, if at any time in the taxation year the total fair market value of all properties held by the trust or partnership that are Canadian real, immovable or resource properties is greater than 50% of the equity value of the trust or partnership; or

(*c*) a property that the trust or partnership or a person, or a partnership, with whom the trust or partnership does not deal at arm's length uses at that time in the course of carrying on a business in Canada.

"public market" « *marché public* »

"public market" includes any trading system or other organized facility through which securities that are qualified for public distribution may be exchanged, but does not include a facility that is operated solely to carry out the issuance of a security or its redemption, acquisition or cancellation by its issuer.

"real estate investment trust" « *fiducie de placement immobilier* »

"real estate investment trust", for a taxation year, means a trust that is resident in Canada throughout the taxation year, if

(*a*) the trust at no time in the taxation year holds any non-portfolio property other than real or immovable properties situated in Canada;

(*b*) the total of the trust's incomes for the taxation year from properties and its taxable capital gains from dispositions of real or immovable properties in the taxation year is not less than 95% of its income for the taxation year;

(*c*) the total of the trust's incomes for the taxation year that are directly or indirectly attributable to real or immovable properties situated in Canada or to mortgages, or hypothecs, on real or immovable properties situated in Canada, and its taxable capital gains from dispositions of real or immovable properties situated in Canada, is not less than 75% of its income for the taxation year; and

(*d*) at no time in the taxation year is the total fair market value of all properties held by the trust, each of which is a real or immovable property situated in Canada, cash, or a property described in clause 212(1)(*b*)(ii)(C), less than 75% of the equity value of the trust at that time.

"real or immovable property" « *bien immeuble ou réel* »

"real or immovable property", of a taxpayer,

(*a*) includes a security held by the taxpayer, if the security is a security of a trust that satisfies (or of any other entity that would, if it were a trust, satisfy) the conditions set out in paragraphs (*a*) to (*d*) of the definition "real estate investment trust"; but

(*b*) does not include any depreciable property that is property of a prescribed class of the taxpayer in respect of which the rate allowed by the regulations made for the purpose of paragraph 20(1)(*a*) is greater than 5%.

"security" « *titre* »

"security" of a particular entity means any right, whether absolute or contingent, conferred by the particular entity or by an entity that is affiliated with the particular entity, to receive, either immediately or in the future, an amount that can reasonably be regarded as all or any part of the capital, of the revenue or of the income of the particular entity, or as interest paid or payable by the particular entity, and for greater certainty includes

(*a*) a liability of the particular entity;

(*b*) if the particular entity is a corporation;

(i) a share of the capital stock of the corporation, and

(ii) a right to control in any manner whatever the voting rights of a share of the capital stock of the corporation,

(*c*) if the particular entity is a trust, an income or a capital interest in the trust;

(*d*) if the particular entity is a partnership, an interest as a member of the partnership; and

(*e*) a right to, or to acquire, anything described in any of paragraphs (*a*) to (*d*) and this paragraph.

"SIFT trust" « *fiducie intermédiaire de placement déterminée* »

"SIFT trust", being a specified investment flow-through trust, for a taxation year means a trust (other than a trust that is a real estate investment trust for the taxation year) if, at any time during the taxation year,

(*a*) the trust is resident in Canada;

(*b*) investments in the trust are listed on a stock exchange or other public market; and

(*c*) the trust holds one or more non-portfolio properties.

"subject entity" « *entité déterminée* »

"subject entity" means a person or partnership that is

(*a*) a corporation resident in Canada;

(*b*) a trust resident in Canada;

(*c*) a Canadian resident partnership; or

(*d*) a non-resident person, or a partnership that is not described in paragraph (*c*), the principal source of income of which is one or any combination of sources in Canada.

(2) Subsection (1) applies in respect of taxation years that end after 2006, except that

(*a*) if interests in or other securities of a partnership were, before November 1, 2006, listed on a stock exchange or other public market, subsection (1) does not apply in respect of the partnership or its members for its taxation years that end before 2011; and

(*b*) if units in or other securities of a trust were, before November 1, 2006, listed on a stock exchange or other public market, subsection (1) does not apply in respect of the trust for its taxation years that end before 2011.

8. (1) Section 126 of the Act is amended by adding the following after subsection (7):

Deemed dividend — partnership

(8) If an amount is deemed by subsection 96(1.11) to be a taxable dividend received by a person in a taxation year of the person in respect of a partnership, and it is reasonable to consider that all or part of the amount (in this subsection referred to as the "foreign-source portion") is attributable to income of the partnership from a source in a country other than Canada, the person is deemed for the purposes of this section to have an amount of income from that source for that taxation year equal to the amount determined by the formula

A x B/C

where

A is the total amount included under subsection 82(1) in computing the income of the person in respect of the taxable dividend for that taxation year;

B is the foreign-source portion; and

C is the amount of the taxable dividend deemed to be received by the person.

(2) Subsection (1) applies in respect of taxation years of a partnership that end after 2006, except that if interests in or other securities of a partnership were, before November 1, 2006, listed on a stock exchange or other public market, subsection (1) does not apply in respect of the partnership or its members for its taxation years that end before 2011.

9. (1) The Act is amended by adding the following after section 196:

Part IX.1

Tax on SIFT Partnership

Definitions

197. (1) The following definitions apply in this Part and in section 96.

"non-portfolio earnings" « *gains hors portefeuille* »

"non-portfolio earnings" of a SIFT partnership for a taxation year means the amount that would, if the SIFT partnership were a SIFT trust, be its non-portfolio earnings for the taxation year as determined under section 122.1.

"SIFT partnership" « *société de personnes intermédiaire de placement déterminée* »

"SIFT partnership", being a specified investment flow-through partnership, for any taxation year, means a partnership if, at any time during the taxation year,

(*a*) the partnership is a Canadian resident partnership;

(*b*) investments (within the meaning assigned by section 122.1) in the partnership are listed on a stock exchange or other public market; and

(*c*) the partnership holds one or more non-portfolio properties.

"taxable non-portfolio earnings" « *gains hors portefeuille imposables* »

"taxable non-portfolio earnings" of a SIFT partnership, for a taxation year, means the lesser of

(*a*) the amount that would, if the SIFT partnership were a taxpayer for the purposes of Part I, be its income for the taxation year as determined under section 3, and

(*b*) its non-portfolio earnings for the taxation year.

Tax on partnership income

(2) Every partnership that is a SIFT partnership for a taxation year is liable to a tax under this Part equal to the amount determined by the formula

$$A \times (B + C)$$

where

A is the taxable non-portfolio earnings of the SIFT partnership for the taxation year;

B is the net corporate income tax rate in respect of the SIFT partnership for the taxation year; and

C is the provincial SIFT tax factor for the taxation year.

Ordering

(3) This Part and section 122.1 are to be applied as if this Act were read without reference to subsection 96(1.11).

Partnership to file return

(4) Every member of a partnership that is liable to pay tax under this Part for a taxation year shall — on or before the day on or before which the partnership return is required to be filed for the year under section 229 of the *Income Tax Regulations* — file with the Minister a return for the taxation year under this Part in prescribed form containing an estimate of the tax payable by the partnership under this Part for the taxation year.

Authority to file return

(5) For the purposes of subsection (4), if, in respect of a taxation year of a partnership, a particular member of the partnership has authority to act for the partnership,

(*a*) if the particular member has filed a return as required by this Part for a taxation year, each other person who was a member of the partnership during the taxation year is deemed to have filed the return; and

(*b*) a return that has been filed by any other member of the partnership for the taxation year is not valid and is deemed not to have been filed by any member of the partnership.

Provisions applicable to Part

(6) Subsection 150(2), sections 152, 156, 156.1, 158, 159, 161 to 167 and Division J of Part I apply to this Part, with any modifications that the circumstances require, and for greater certainty,

(*a*) a notice of assessment referred to in subsection 152(2) in respect of tax payable under this Part is valid notwithstanding that a partnership is not a person; and

(*b*) notwithstanding subsection 152(4), the Minister may at any time make an assessment or reassessment of tax payable under this Part or Part I to give effect to a determination made by the Minister under subsection 152(1.4), including the assessment or reassessment of Part I tax payable in respect of the disposition of an interest in a SIFT partnership by a member of the partnership.

Payment

(7) Every SIFT partnership shall pay to the Receiver General, on or before its SIFT partnership balance-due day for each taxation year, its tax payable under this Part for the taxation year.

(2) Subsection (1) applies in respect of taxation years of a partnership that end after 2006, except that it does not apply in respect of a partnership for its taxation years that end before 2011 if interests in or other securities of the partnership were, before November 1, 2006, listed on a stock exchange or other public market.

10. (1) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

"Canadian real, immovable or resource property" *« bien immeuble ou réel ou avoir minier au Canada »*

"Canadian real, immovable or resource property" means

(*a*) a property that would, if this Act were read without reference to the definition "real or immovable property" in section 122.1, be a real or immovable property situated in Canada,

(*b*) a Canadian resource property,

(*c*) a timber resource property,

(*d*) a share of the capital stock of a corporation, an income or a capital interest in a trust or an interest in a partnership, if more than 50% of the fair market value of the share or interest is derived directly or indirectly from one or any combination of properties described in paragraphs (*a*) to (*c*), or

(*e*) any right to or interest in — or, for civil law, any right to or in — any property described in any of paragraphs (*a*) to (*d*);

"Canadian resident partnership" *« société de personnes résidant au Canada »*

"Canadian resident partnership" means a partnership that, at any time in respect of which the expression is relevant,

(*a*) is a Canadian partnership,

(*b*) would, if it were a corporation, be resident in Canada (including, for greater certainty, a partnership that has its central management and control in Canada), or

(*c*) was formed under the law of a province;

"net corporate income tax rate" *« taux net d'imposition du revenu des sociétés »*

"net corporate income tax rate" in respect of a SIFT trust or SIFT partnership for a taxation year means the amount, expressed as a decimal fraction, by which

(*a*) the percentage rate of tax provided under paragraph 123(1)(*a*) for the taxation year

exceeds

(*b*) the total of

(i) the percentage that would, if the SIFT trust or SIFT partnership were a corporation, be its general rate reduction percentage, within the meaning assigned by subsection 123.4(1), for the taxation year, and

(ii) the percentage deduction from tax provided under subsection 124(1) for the taxation year;

"non-portfolio property" *« bien hors portefeuille »*

"non-portfolio property" has the meaning assigned by section 122.1;

"provincial SIFT tax factor" *« facteur fiscal provincial »*

"provincial SIFT tax factor" for a taxation year means the decimal fraction 0.13;

"public market" *« marché public »*

"public market" has the meaning assigned by section 122.1;

"SIFT partnership" *« société de personnes intermédiaire de placement déterminée »*

"SIFT partnership" has the meaning assigned by Part IX.1;

"SIFT partnership balance-due day" *« date d'échéance du solde »*

"SIFT partnership balance-due day", in respect of a taxation year of a SIFT partnership, means the day on or before which the partnership is required to file a return for the taxation year under section 229 of the *Income Tax Regulations*;

"SIFT trust" « *fiducie intermédiaire de placement déterminée* »

"SIFT trust" has the meaning assigned by section 122.1;

(2) Subsection (1) applies in respect of taxation years that end after 2006, except that

(*a*) if interests in or other securities of a partnership were, before November 1, 2006, listed on a stock exchange or other public market, subsection (1) does not apply in respect of the partnership or its members for its taxation years that end before 2011; and

(*b*) if units in or other securities of a trust were, before November 1, 2006, listed on a stock exchange or other public market, subsection (1) does not apply in respect of the trust for its taxation years that end before 2011.

11. (1) Subsection 249(1) of the Act is amended by striking out the word "and" at the end of paragraph (*b*), by adding the word "and" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) in the case of a Canadian resident partnership, a fiscal period.

(2) Subsection (1) applies in respect of taxation years of a partnership that end after 2006, except that if interests in or other securities of a partnership were, before November 1, 2006, listed on a stock exchange or other public market, subsection (1) does not apply in respect of the partnership or its members for its taxation years that end before 2011.

AMENDMENTS TO THE INCOME TAX REGULATIONS

12. (1) The portion of section 229 of the *Income Tax Regulations* before paragraph (*a*) is replaced by the following:

Partnership Return

229. (1) Every member of a partnership that carries on a business in Canada, or that is a Canadian partnership or a SIFT partnership, at any time in a fiscal period of the partnership shall make for that period an information return in prescribed form containing the following information

(2) Subsection (1) applies in respect of taxation years of a partnership that end after 2006, except that if interests in or other securities of a partnership were, before November 1, 2006, listed on a stock exchange or other public market, subsection (1) does not apply in respect of the partnership or its members for its taxation years that end before 2011.

13. (1) Part XXVI of the Regulations is amended by adding the following after section 2607:

SIFT trusts

2608. For the purposes of this Part, if the individual is a SIFT trust, a reference to income earned in a taxation year shall be read as a reference to the amount that would, if this Part were read without reference to this section, be the amount, if any, by which its income for the taxation year exceeds its taxable SIFT trust distributions for the taxation year.

(2) Subsection (1) applies after 2006.

EXPLANATORY NOTES TO LEGISLATIVE PROPOSALS CONCERNING SPECIFIED INVESTMENT FLOW-THROUGH TRUSTS AND PARTNERSHIPS

Clause 1
ACB deduction

ITA
53(2)(*h*)(i.1)

Under paragraph 53(2)(*h*) of the *Income Tax Act* (the Act), certain amounts are generally deducted in computing the adjusted cost base (ACB) to a beneficiary of the beneficiary's capital interest in a trust. Subparagraph 53(2)(*h*)(i.1) generally ensures that distributions from a trust reduce the trust beneficiary's ACB of their capital interest in the trust, unless the amount represents proceeds of disposition of the interest or is otherwise included in the beneficiary's income. This subparagraph is amended, as a consequence of a series of amendments implementing new rules for "SIFT partnerships" and "SIFT trusts" (both of which terms are defined in subsection 248(1) of the Act), to exclude from the adjustment rule any amount that has been deemed by new subsection 104(16) of the Act to be a dividend received by the beneficiary.

This amendment applies to the 2007 and subsequent taxation years.

Clause 2
"eligible dividend"

ITA
89(1)

The definition "eligible dividend" in subsection 89(1) of the Act identifies those dividends that qualify, in the hands of individuals resident in Canada, for the proposed enhanced dividend "gross-up" and the enhanced dividend tax credit. As part of a series of amendments implementing new rules for "SIFT partnerships" and "SIFT trusts" (both of which terms are defined in subsection 248(1) of the Act), the definition is amended to include as eligible dividends certain amounts distributed by SIFT trusts to their beneficiaries and certain amounts allocated by SIFT partnerships to their members. In broad terms, these are amounts of a SIFT trust's (or SIFT partnership's) "non-portfolio earnings" distributions (or allocations) that have been taxed at a rate comparable to the rate that applies to corporations. The notes relating to new section 122 and new Part IX.1 of the Act explain in more detail how those amounts are taxed.

This amendment applies to the 2007 and subsequent taxation years.

Clause 3
Partnerships and their members

ITA
96

Section 96 of the Act provides general rules for determining the income or loss of a partnership and its members.

Deemed dividend of SIFT partnership

ITA
96(1.11)

New subsection 96(1.11) of the Act is introduced concurrently with the introduction of the tax payable by a SIFT partnership under Part IX.1 of the Act. Subsection 96(1.11) effectively provides that Part IX.1 tax payable by a SIFT partnership reduces the amount of "taxable non-portfolio earnings" (as defined in subsection 197(1) of the Act) that will be subject to tax in the hands of the members of the partnership under Part I of the Act. More specifically, paragraph 96(1.11)(*a*) amends the wording of paragraph 96(1)(*f*) of the Act where Part IX.1 tax is payable in such a way as to reduce the allocation of partnership income to a member of the partnership by an amount representing the member's share of the taxable non-portfolio earnings.

A portion of that allocation is deemed by paragraph 96(1.11)(*b*) to be a dividend received by the partnership from a taxable Canadian corporation. This deemed dividend is allocated to the members of the partnership in the same proportion as the taxable non-portfolio earnings. The deemed dividend is the amount by which the taxable non-portfolio earnings of the partnership for a taxation year exceeds the tax payable under Part IX.1 for the year.

These amendments apply in respect of taxation years of a partnership that end after 2006, except that they do not apply in respect of a partnership for its taxation years that end before 2011 if interests in or other securities of the partnership were, before November 1, 2006, listed on a stock exchange or other public market.

Clause 4
Trusts and their beneficiaries

ITA
104

Section 104 of the Act includes many of the rules that apply to the income taxation of trusts and their beneficiaries.

Deduction in computing trust's income

ITA
104(6)

Subsection 104(6) of the Act generally permits a trust to deduct, in computing its income for a taxation year, any income payable to a beneficiary under the trust. Paragraphs 104(6)(*a*) to (*a.3*) apply to various special kinds of trust, while paragraph 104(6)(*b*) applies more generally. Paragraph 104(6)(*b*) calculates the amount that a trust can deduct against its income. Generally, the deductible amount is the amount of the trust's income that is payable to the beneficiaries and the amount included in the income of the beneficiaries under subsection 105(2).

As part of a series of measures to implement new rules for "SIFT trusts" (defined in subsection 248(1) of the Act), paragraph 104(6)(*b*) is amended in two respects.

First, subparagraph 104(6)(*b*)(i) is amended to add the term "adjusted distributions amount" to refer to the amount determined under that subparagraph.

Second, new subparagraph 104(6)(*b*)(iv) is added. This new provision limits the deduction that a SIFT trust can claim under subsection 104(6). The provision's general effect is to prevent a SIFT from deducting under subsection 104(6) any amount of its "non-portfolio earnings" (defined in new section 122.1 of the Act) that it has made payable to a beneficiary. The structure of the provision has the result of applying an ordering as between non-portfolio earnings (NPE) and other income, such that NPE is the last income to be considered to have been distributed. This result will typically be beneficial to the SIFT trust, as it will allow it to use deductions in computing taxable income – notably non-capital loss carryovers from other taxation years – to reduce the amount of its NPE that are subject to tax.

Specifically, new subparagraph 104(6)(*b*)(iv) reduces the amount that a SIFT trust can deduct under subsection 104(6), in computing its income for a taxation year, by the excess of the SIFT trust's adjusted distributions over that part of its income that is not NPE. This second amount is in turn computed through subtraction: it is the amount by which the SIFT trust's gross income for the taxation year (that is, before the subsection 104(6) deduction itself) exceeds its NPE for the taxation year.

These amendments to subsection 104(6) apply in respect of taxation years that end after 2006, except that they do not apply in respect of a trust for its taxation years that end before 2011 if units in or other securities of the trust were, before November 1, 2006, listed on a stock exchange or other public market.

SIFT deemed dividend

ITA
104(16)

New subsection 104(16) of the Act is a central part of a series of measures to implement new rules for trusts that are "specified investment flow-throughs" or "SIFT trusts" (newly defined in subsection 248(1) of the Act). Subsection 104(16) recharacterizes as taxable dividends certain amounts that become payable to a beneficiary of a SIFT trust. These correspond to amounts that have borne tax at the level of the SIFT trust, and which it has not been permitted to deduct in computing its income. The combined effect is thus to treat these amounts in much the same manner as if they had been earned by – and distributed as dividends from – a corporation.

In order for subsection 104(16) to apply, an amount must be determined under new subparagraph 104(6)(*b*)(iv) of the Act in respect of a SIFT trust for a taxation year. This "non-deductible distributions amount" represents the portion of the SIFT trust's "non-portfolio earnings" (now defined in new section 122.1 of the Act) that is considered to have become payable to its beneficiaries in the taxation year.

If a SIFT trust has a non-deductible distributions amount for a taxation year, paragraph 104(16)(*a*) provides that every beneficiary to whom any amount became payable by the trust in the year is treated as having received a taxable dividend from a taxable Canadian corporation. (Note that subsection 104(24) applies in determining whether an amount has become payable to a beneficiary.) The number and timing of these deemed dividends will correspond to the number and timing of the amounts that became payable to beneficiaries: in effect, a proportionate part of each amount that becomes payable is treated as having been a taxable dividend.

Paragraph 104(16)(*b*) sets out a formula for determining the amount of a dividend received under paragraph 104(16)(*a*) from a SIFT trust by a beneficiary. The formula apportions the SIFT trust's non-deductible distributions amount for the taxation year in question. A given dividend under paragraph (*a*) is linked to a particular amount that became payable to the beneficiary. The amount of the dividend is thus that proportion of the non-deductible distributions amount that the particular amount that became payable is of the total of all amounts, each of which became payable in the taxation year by the SIFT trust to a beneficiary under the SIFT trust.

If an amount is treated as a dividend because of subsection 104(16), it will be subject to tax in the hands of a taxable beneficiary under the rules that apply to taxable dividends received from corporations resident in Canada. To prevent the amount from also being included in income under subsection 104(13) of the Act as income from a trust, paragraph 104(16)(*c*) is introduced. This paragraph treats the amount of any dividend under paragraph 104(16)(*a*) as not being an amount payable to the beneficiary, for the purpose of subsection 104(13). (It should be noted that the amount remains an amount payable to the beneficiary for the purposes of, for example, subsection 104(6).)

Paragraph 104(16)(*d*) ensures that Part XIII of the Act applies appropriately to amounts that are deemed to be dividends by paragraph 104(16)(*a*). The SIFT trust is treated for this purpose as a resident corporation that paid the dividend. This ensures, among other things, that the SIFT trust is responsible for the same obligation to withhold tax under Part XIII as a corporation resident in Canada is when it pays a dividend to a non-resident.

New subsection 104(16) applies in respect of taxation years that end after 2006, except that it does not apply in respect of a trust for its taxation years that end before 2011 if units in or other securities of the trust were, before November 1, 2006, listed on a stock exchange or other public market.

Amount payable

ITA
104(24)

Subsection 104(24) of the Act is relevant in determining when an amount has become payable to a beneficiary under a trust, for the purposes of certain provisions of the Act. New subsection 104(16) is added to the list of those provisions. This amendment applies in respect of taxation years that end after 2006, except that it does not apply in respect of a trust for its taxation years that end before 2011 if units in or other securities of the trust were, before November 1, 2006, listed on a stock exchange or other public market.

Clause 5
Integration with provincial taxes

ITA
120(3)

Section 120 of the Act sets out rules for the integration of the federal and provincial income taxes on individuals. Subsection 120(3) defines the phrase "the individual's income for the year" for the purposes of the section. Trusts are individuals for income tax purposes and, unless specially provided for, are subject to section 120.

As part of a series of measures to implement new rules for "SIFT trusts" (defined in subsection 248(1) of the Act), this definition is amended. In brief, those measures treat certain distributions by SIFT trusts to their beneficiaries more like dividends: the SIFT trust is prevented from deducting the amount in computing its income, the amount is taxed in the hands of the SIFT trust, and the distribution becomes a taxable dividend in the hands of the recipient beneficiary.

Since the tax is applied, at the trust level, at a rate that approximates a combined federal and provincial corporate income tax rate, it is appropriate to exclude amounts that have been subject to the tax from what might otherwise be an overlapping provincial tax. It is also appropriate not to subject these amounts to the additional federal income tax that applies to an individual's income not earned in a province.

This amendment – which takes the form of a new paragraph 120(3)(*d*) – ensures that to the extent the income of a SIFT trust has borne this corporate-style tax, it is neither taxed provincially (in those provinces that have agreed to follow the federal measurement of taxable income) nor subjected to the additional federal tax.

This amendment applies in respect of taxation years that end after 2006, except that it does not apply in respect of a trust for its taxation year that end before 2011 if units in or other securities of the trusts were, before November 1, 2006, listed on a stock exchange or other public market.

Clause 6
Tax payable by *inter vivos* trust

ITA
122(1) and (1.01)

Section 122 of the Act sets out, for most *inter vivos* trusts, the tax payable under Part I of the Act. Subsection 122(1) provides the section's basic rules: the rate of the tax is 29%; and the base is a trust's "amount taxable" for a taxation year. "Amount taxable" is defined in subsection 117(2) of the Act as taxable income for the taxation year, or taxable income earned in Canada for the taxation year, in the case of a non-resident.

As part of a series of measures to implement new rules for "SIFT trusts" (defined in subsection 248(1) of the Act), subsection 122(1) is amended to include an additional amount in the tax payable by a SIFT trust. This additional amount is computed, in new paragraph 122(1)(*b*), as the product of a specified tax rate and the SIFT trust's "taxable SIFT distributions" for the taxation year. (It should be noted that while it will at present be a positive amount, the product determined under paragraph 122(1)(*b*) could, depending on future tax rates, be negative in some cases.)

Conceptually, the rate of tax under paragraph 122(1)(*b*) is the difference between a combined federal-provincial tax rate on corporate income (using a reasonable surrogate for provincial rates), and the federal income tax that applies to *inter vivos* trust income. Mechanically, the rate is a positive or negative decimal fraction that has

three components. The first component is the "net corporate income tax rate" in respect of the SIFT trust for the taxation year. This term, newly defined in subsection 248(1) of the Act, in effect refers to the general corporate tax rate net of the rate reduction applicable for the taxation year and net of the "provincial abatement". To this is added the "provincial SIFT tax factor" for the taxation year (also defined in subsection 248(1); currently 0.13). The final component is the decimal equivalent of the rate of tax that applies under paragraph 122(1)(*a*) to the trust's amount taxable: this is deducted from the total of the first two components.

The base for the tax under paragraph 122(1)(*b*), the SIFT trust's taxable SIFT distributions for the taxation year, is defined in new subsection 122(3) of the Act. The notes to that subsection describe this amount in detail. One important point is that a SIFT trust's taxable SIFT distributions amount is not necessarily the same as its "non-deductible distributions amount". The latter amount is in effect treated as one or more taxable dividends in the hands of the SIFT trust's beneficiaries, and taxed accordingly. The SIFT trust's taxable SIFT distributions amount, meanwhile, is the amount that will be subject to tax, in the hands of the SIFT itself, at a rate that approximates a combined federal and provincial corporate income tax rate. Just as a corporation may pay a dividend without having had any of its own income subject to tax (because, for example, it has used a loss carryover to reduce its taxable income to nil), the beneficiaries of a SIFT trust may be treated as having received taxable dividends even though the SIFT trust itself pays no tax under paragraph 122(1)(*b*).

Amended subsection 122(1) is followed by a new subsection 122(1.01). This provision ensures that if the calculation under subsection (1) in respect of a trust (other than one that is exempt from tax) produces a negative amount, the absolute value of that amount is treated as having been paid on account of the trust's tax liability under Part I of the Act. This will allow the trust to apply the resulting overpayment against any other tax or related liability or, if it has no such liabilities, to obtain a refund.

These amendments apply in respect of taxation years that end after 2006, except that they do not apply in respect of a trust for its taxation years that end before 2011 if units or other securities of the trust were, before November 1, 2006, listed on a stock exchange or other public market.

Definitions

ITA
122(3)

New subsection 122(3) of the Act sets out two definitions that relate to the taxation of SIFT trusts. These definitions apply in respect of taxation years that end after 2006, except that they do not apply in respect of a trust for its taxation years that end before 2011 if units or other securities of the trust were, before November 1, 2006, listed on a stock exchange or other public market.

"non-deductible distributions amount"

A SIFT trust's "non-deductible distributions amount" is defined in new subsection 104(16). This definition is adopted in subsection 122(3) as well. The "non-deductible distributions amount" represents in effect the portion of the SIFT trust's "non-portfolio earnings" (now defined in new section 122.1 of the Act) that is considered (by way of subparagraph 104(6)(*b*)(iv)) to have become payable to its beneficiaries in the taxation year.

"taxable SIFT trust distributions"

The "taxable SIFT trust distributions" of a SIFT trust for a taxation year is the lesser of two amounts. The first amount is the SIFT trust's "amount taxable" for the taxation year. Since a SIFT trust must be resident in Canada, this is the same as its taxable income for the taxation year (see subsection 117(2) of the Act).

The second amount is a "grossed-up" function of the SIFT trust's non-deductible distributions amount for the taxation year. The gross-up restores the amount to its presumed pre-tax equivalent, and so ensures that the tax under new paragraph 122(1)(*b*) applies to the full amount of the SIFT's earnings that supported its non-deductible distributions.

Clause 7
SIFT trust distributions – definitions

ITA
122.1

New section 122.1 of the Act sets out a number of definitions that apply for the purposes of the measures to implement new rules for "SIFT trusts" and, in some cases, "SIFT partnerships" (both of which terms are defined in subsection 248(1) of the Act). These definitions apply for the purposes of sections 104 and 122, as well as for the purposes of new section 122.1 itself. They apply in respect of taxation years that end after 2006, except that they do not apply in respect of a trust or partnership for its taxation years that end before 2011 if units or interests in or other securities of the trust or partnership were, before November 1, 2006, listed on a stock exchange or other public market.

"entity"

An "entity" is defined to mean a corporation, a trust or a partnership.

"equity value"

The "equity value" of an entity at any time is the total fair market value of all interests in the entity. More specifically, it is the total fair market value of all of the issued and outstanding shares of a corporation, of all of the income and capital interests in a trust, or of all of the interests in a partnership.

"investment"

"Investment" in a trust or partnership is meant to cover a broad range of properties and rights. It encompasses not only a property that is a "security" (itself newly defined in this section) of the trust or partnership, but also any right that can reasonably be considered to replicate a return on, or the value of, such a security.

"non-portfolio earnings"

A SIFT trust's "non-portfolio earnings" for a taxation year is the total of two amounts. The first amount, in paragraph (*a*) of the definition, is the total net amount of the SIFT trust's incomes for the year from businesses it carried on in Canada and from "non-portfolio properties". Besides the netting of any losses for the taxation year from such sources, taxable dividends are excluded from this amount. The second amount, in paragraph (*b*) of the definition, is the net amount of the SIFT trust's taxable capital gains from dispositions in the taxation year of non-portfolio properties.

"non-portfolio property"

A trust's, or partnership's, "non-portfolio property" is a property of any of three types. The first type is comprised of certain securities of a "subject entity" (newly defined in this section). These are securities that either:

- have a total fair market value that is greater than 10% of the equity value of the subject entity; or
- make up – together with any securities that the trust or partnership holds of entities affiliated with the subject entity – more than 50% of the equity value of the trust or partnership.

The second type of non-portfolio property is a "Canadian real, immovable or resource property" (see the new definition in subsection 248(1) of the Act). A property that meets this definition will be a non-portfolio property of the trust or partnership only if the total fair market value of all of the Canadian real, immovable or resource properties held by the trust or partnership is greater than 50% of its equity value. It should be noted that for this purpose there is no difference among the various kinds of Canadian real, immovable or resource properties. For example, assume that a trust that has an equity value of $1 billion holds Canadian resource properties that have a total fair market value of $350 million, and real properties situated in Canada that have a total fair market value of $175 million. All of those Canadian resource properties and real properties are non-portfolio properties of the trust, since their total fair market value ($525 million) exceeds 50% of its equity value.

The third type of non-portfolio property is property that the trust or partnership (or a non-arm's length trust or partnership) uses in the course of carrying on a business in Canada.

"public market"

"Public market" is defined to include any trading system or other organized facility through which securities that are qualified for public distribution may be exchanged. Excluded from the definition, however, is any facility that operates solely for the issuance or redemption (or cancellation or acquisition) of a security by its issuer. For example, the fact that a mutual fund allows unitholders to redeem their units does not mean that the mutual fund is operating a public market in respect of the units.

"real estate investment trust"

A trust is a "real estate investment trust" (REIT) for a taxation year if it is resident in Canada throughout the year and meets four conditions. First, the trust must at no time in the year hold any non-portfolio property other than real or immovable properties situated in Canada.

The second condition is that the total of the trust's property income – of all types – for the taxation year and its taxable capital gains from dispositions in the year of real or immovable properties must be no less than 95% of its income for the year.

Third, at least 75% of the trust's income for the taxation year must be made up of any combination of income from real or immovable properties situated in Canada, mortgages and hypothecs on real or immovable properties situated in Canada and taxable capital gains from dispositions of real or immovable properties situated in Canada. Fourth, it must be the case that at no time in the year does the total fair market value of all real or immovable properties situated in Canada, cash and properties described in clause 212(1)(*b*)(ii)(C) of the Act (generally speaking, debt of or guaranteed by a government) equal less than 75% of the trust's equity value.

"real or immovable property"

"Real or immovable property" is a term whose meaning derives from the general law. Its definition in this context modifies that meaning in two respects. First, there is included as real or immovable property a security of a trust that itself satisfies the four conditions that make up the definition "real estate investment trust". (Also included is a security of an entity other than a trust that would satisfy those conditions if it were a trust.) Second, certain depreciable property is excluded from the definition. This is depreciable property with a "capital cost allowance" rate of greater than 5%.

"security"

A "security" of an entity is any of a wide variety of rights, conferred by the entity in question or by another entity that is affiliated with it. What these rights have in common is that they entitle, or may entitle, someone to receive an amount of the capital, revenue or income of the entity in question, or an amount of interest paid or payable by it. "Security" thus encompasses – among other rights – shares of a corporation, interests in a trust or partnership, and liabilities of an entity, as well as rights to acquire any of those.

"SIFT trust"

A trust is a "specified investment flow-through trust" or "SIFT trust" for a taxation year if at any time in the taxation year it is resident in Canada, investments in it are listed on a stock exchange or other public market, and it holds one or more non-portfolio properties. A real estate investment trust (REIT) is not a SIFT trust.

"subject entity"

A "subject entity" is a trust or corporation that is resident in Canada, a "Canadian resident partnership" (newly defined in subsection 248(1) of the Act) or – if its principal source of income is one or any combination of sources in Canada – a non-resident person or a partnership other than a Canadian resident partnership.

Clause 8
Deemed dividend – partnership

ITA
126(8)

Subsections 126(1) and (2) of the Act provide rules under which a taxpayer may deduct, from tax otherwise payable, credits in respect of foreign income tax that they have paid on foreign non-business income and foreign business income, respectively. Neither credit may exceed the Canadian tax otherwise payable in respect of the foreign-sourced income. Canadian tax otherwise payable on foreign source income is generally determined by reference to the ratio of the net income from sources in a foreign country to total income. In the case of foreign-sourced income of a partnership, the tax credit is available to members of the partnership.

Some partnerships may have foreign-sourced income that is "non-portfolio earnings" (as that term is defined in section 122.1 and in subsection 197(1) of the Act) that are taxable under Part IX.1 of the Act. For the purpose of the application of the Act to the members of the partnership, the amount of partnership non-portfolio earnings that is allocable to partners is reduced by the amount of Part IX.1 tax payable, and the balance is deemed to be a dividend received by the partnership from a taxable Canadian corporation. (For more information, refer to the Explanatory Notes for subsection 96(1.11) and new section 197.)

New subsection 126(8) is introduced to ensure that, for the purpose of calculating the credits available under section 126, the full amount of the taxable dividend applicable to that foreign-sourced income that is non-portfolio earnings ("grossed-up" by subsection 82(1), if applicable) is included in the foreign tax credit calculation. In addition, the dividend is clarified as being from a foreign source, notwithstanding paragraph 96(1.11)(*b*) of the Act, to the extent that the non-portfolio earnings are from a foreign source.

These amendments apply in respect of taxation years of a partnership that end after 2006, except that they do not apply in respect of a partnership for its taxation years that end before 2011 if interests in or other securities of the partnership were, before November 1, 2006, listed on a stock exchange or other public market.

Clause 9

Part IX.I
Tax on SIFT Partnership

ITA
197

New section 197 of the Act imposes a tax on certain publicly-listed partnerships as if they were persons. The tax applies on income from certain property (referred to as "non-portfolio property") and on income from carrying on business in Canada. The tax rate imposed under new Part IX.1 of the Act reflects, generally, the percentage that would be the federal corporate tax rate, less the federal abatement that would apply to a corporation subject to provincial tax, plus an amount that serves as a proxy for tax to be collected on behalf of provincial governments.

Section 197 of the Act is introduced concurrently with new subsection 96(1.11) of the Act. Subsection 96(1.11) provides that Part IX.1 tax payable by a SIFT partnership reduces the amount of income that will be subject to tax in the hands of the members of the partnership under Part I of the Act. Subsection 96(1.11) also provides that the difference between the amount taxable under Part IX.1 and the tax payable is deemed to be a dividend received by the partnership from a taxable Canadian corporation. In the result, Canadian-resident individuals who are members of a SIFT partnership will generally be eligible to recover their share of the partnership's Part IX.1 taxes as a dividend tax credit under section 121 of the Act. Corporate members may be eligible for a dividend deduction under section 112 of the Act. For additional information, refer to the Explanatory Notes accompanying subsection 96(1.11).

These amendments apply in respect of taxation years of a partnership that end after 2006, except that they do not apply in respect of a partnership for its taxation years that end before 2011 if interests in or other securities of the partnership were, before November 1, 2006, listed on a stock exchange or other public market.

Definitions

ITA
197(1)

New subsection 197 of the Act defines a number of terms that apply for the purposes of Part IX.1 of the Act.

"non-portfolio earnings"

The expression "non-portfolio property" of a SIFT partnership for a taxation year means the amount that would, if the partnership were a SIFT trust, be its non-portfolio earnings, within the meaning assigned by section 122.1 of the Act. Refer to the Explanatory Notes to that section for more information.

"SIFT partnership"

A "SIFT partnership", being a specified flow-through investment partnership, for a taxation year means a Canadian resident partnership if, at any time in the taxation year, the partnership holds non-portfolio property and its securities are listed on a stock exchange or other public market. The term "security" is defined by reference to section 122.1 of the Act, and in the case of a partnership includes, for instance, the interest of a member of the partnership. Refer to the Explanatory Notes accompanying that section for more information.

"taxable non-portfolio earnings"

The "taxable non-portfolio earnings" of a SIFT partnership for a taxation year is the lesser of

(a) the amount that would, if the SIFT partnership were a taxpayer for the purposes of Part I of the Act, be its income for the taxation year as determined under section 3 of the Act, and

(b) its non-portfolio earnings for the taxation year.

As such, if a SIFT partnership has a net loss from a source that is not non-portfolio property, that loss will generally reduce the amount that is subject to Part IX.1 tax to the extent that it exceeds income from other sources (i.e. sources that are not non-portfolio properties). An example of an exception would be an allowable capital loss, if the partnership has no taxable capital gains against which to offset that loss.

Tax on partnership income

ITA
197(2)

New subsection 197(2) of the Act provides a formula for calculating the Part IX.1 tax that is imposed on the taxable non-portfolio earnings of a SIFT partnership. The rate is the sum of the "net corporate income tax rate" for a taxation year and the "provincial SIFT tax factor". For more information on these terms, refer to the Explanatory Notes accompanying these new definitions in subsection 248(1) of the Act.

Ordering

ITA
197(3)

New subsection 197(3) of the Act provides that Part IX.1 and section 122.1 of the Act are to be read without reference to subsection 96(1.11) of the Act. Subsection 96(1.11) provides that Part IX.1 tax payable by a SIFT partnership reduces the amount of income that will be subject to tax in the hands of the members of the partnership under Part I of the Act. Subsection 96(1.1) also provides that the difference between the amount

taxable under Part IX.1 and the tax payable is deemed to be a dividend received by the partnership from a taxable Canadian corporation.

New subsection 197(3) ensures that the calculation of non-portfolio earnings and, correspondingly, Part IX.1 tax, is unaffected by subsection 96(1.11).

Partnership to file return

ITA
197(4) and (5)

New subsection 197(4) of the Act provides that, for taxation years in which Part IX.1 tax is payable by a SIFT partnership, every person who was a member of the partnership in that year is responsible for the filing of the Part IX.1 return. However, if a member of the partnership who has authority to act for the partnership files the required return, subsection 197(5) of the Act provides that only that return need be filed.

The Part IX.1 return is required to be filed on or before the deadline for which the partnership information return is required to be filed for the year under section 229 of the *Income Tax Regulations*.

Provisions applicable to Part

ITA
197(6)

New subsection 197(6) of the Act provides that certain provisions of Part I of the Act applicable to individuals and relating to assessments, payments and appeals are applicable to Part IX.1 tax with any modifications that the circumstances require. Paragraph 197(6)(*a*) provides that a notice of assessment of tax payable under Part IX.1 is deemed to be valid notwithstanding that a partnership is not a person. In addition, paragraph 197(6)(*a*) provides that the prohibition of reassessment after the normal reassessment period of a member of a SIFT partnership is suspended in order to give effect to a determination made in respect of a partnership under subsection 152(1.4) of the Act.

Payment

ITA
197(7)

New subsection 197(7) of the Act provides that the tax payable by a SIFT partnership under Part IX.1 of the Act shall be paid on or before the "SIFT partnership balance-due day", which is defined in subsection 248(1) as, generally, the day on which the partnership information return is required to be filed for the year under section 229 of the *Income Tax Regulations*.

Clause 10
Definitions

ITA
248(1)

Subsection 248(1) of the Act defines many terms for the purposes of the Act. This subsection is amended by adding, in alphabetical order, several definitions that relate to the taxation of "SIFT trusts" and "SIFT partnerships".

"Canadian real, immovable or resource property"

A "Canadian real, immovable or resource property" is defined to mean four types of properties and any right to or interest in them. The four types of properties are:

(a) a real or immovable property situated in Canada,

(b) a Canadian resource property,

(c) a timber resource property, and

(d) a share of a corporation, an interest in a trust, or an interest in a partnership, if more than 50% of the fair market value of the share or interest is derived from one or any combination of properties described in (a) to (c) above.

"Canadian resident partnership"

The definition "Canadian resident partnership" is introduced consequential to the rules regarding SIFT partnerships. A Canadian resident partnership is a partnership that

(a) is a Canadian partnership (defined in subsection 248(1) and section 102 of the Act as, generally, a partnership all of the members of which are resident in Canada),

(b) would, if it were a corporation, be resident in Canada (including, for greater certainty, a partnership that has its central management and control in Canada or that was formed under the law of Canada or a province), or

(c) was formed under the law of a province.

"net corporate income tax rate"

This definition is introduced as part of a series of amendments implementing new rules for "SIFT partnerships" and "SIFT trusts". This rate, in effect, is the general corporate tax rate less the rate reduction applicable for a corporation for the taxation year less the "provincial abatement". This definition is used in calculating the tax payable on the non-portfolio earnings of a SIFT trust or the taxable non-portfolio earnings of a SIFT partnership.

"non-portfolio property"

The expression "non-portfolio property" has the meaning assigned by section 122.1 of the Act. Refer to the Explanatory Notes to that section for more information.

"provincial SIFT tax factor"

The "Provincial SIFT tax factor" means the decimal fraction 0.13 and is used in calculating the tax payable on the non-portfolio earnings of a SIFT trust or the taxable non-portfolio earnings of a SIFT partnership.

"public market"

The expression "public market" has the meaning assigned by section 122.1 of the Act. Refer to the Explanatory Notes to that section for more information.

"SIFT partnership"

The definition "SIFT partnership" has the meaning assigned by Part IX.1 of the Act. Refer to the Explanatory Notes to that Part for more information.

"SIFT partnership balance-due day"

The definition "SIFT partnership balance-due day" is introduced consequential to the rules regarding SIFT partnerships,. The expression refers to the day on or before which the partnership is required to file an information return for a taxation year under section 229 of the *Income Tax Regulations*.

These amendments apply in respect of taxation years of a trust or partnership that end after 2006, except that they do not apply in respect of taxation years that end before 2011 if units or interests in securities of the trust or partnership were, before November 1, 2006, listed on a stock exchange or other public market.

"SIFT trust"

The definition "SIFT trust" has the meaning assigned in section 122.1. Refer to the Explanatory Notes to that section for more information.

Clause 11
Definition of "taxation year "

ITA
249(1)

Subsection 249(1) of the Act defines "taxation year" in the case of a corporation or an individual. Subsection 249(1) is amended, in conjunction with the introduction of Part IX.1 of the Act, to provide that the taxation year of a Canadian resident partnership is its fiscal period.

These amendments apply in respect of taxation years of a partnership that end after 2006, except that they do not apply in respect of a partnership for its taxation years that end before 2011 if interests in or other securities of the partnership were, before November 1, 2006, listed on a stock exchange or other public market.

Clause 12
Partnership return

ITR
229(1)

Subsection 229(1) of the *Income Tax Regulations* requires every member of a partnership that, at any time in its fiscal period, carries on business in Canada or is a Canadian partnership, to make an information return in prescribed form. Subsection 229(2) of the Regulations allows that such a return filed by one member is deemed to have been filed by all members.

Subsection 229(1) is amended concurrently with the introduction of the tax payable by a SIFT partnership under Part IX.1 of the Act, to require the filing of an information return in respect of a SIFT partnership. For more information, refer to the Explanatory Notes for new subsection 96(1.11) and new section 197 of the Act.

This amendment applies in respect of taxation years of a partnership that end after 2006, except that it does not apply in respect of a partnership for its taxation years that end before 2011 if interests in or other securities of the partnership were, before November 1, 2006, listed on a stock exchange or other public market.

Clause 13
SIFT trusts

ITR
2608

Part XXVI of the *Income Tax Regulations* sets out rules for computing an individual's income earned in a taxation year in a particular province. Trusts are individuals for income tax purposes.

As part of a series of amendments implementing new rules for "SIFT trusts", this section is added to exclude the taxable SIFT trust distributions of a SIFT trust from the computation of its income earned in particular province in a taxation year as the taxable SIFT trust distributions are taxed at a combined federal and provincial rate under the amended section 122.

This amendment applies after 2006.